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EU Expands Under Cloudy Skies

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Summary

The European Union celebrated its largest expansion yet May 1. After the initial rush, a range of social, economic and political challenges will come to the fore as the EU struggles to integrate new members into an old, inflexible system. The potential for nationalist backlash also will restrain deeper integration.

Analysis

EU expansion finally arrived May 1, with 10 Central European and Mediterranean countries joining the 15 current EU members, with (almost) all the rights and privileges of full membership in the world's most exclusive economic club. Expansion raises the EU's total population to approximately 454 million people, with a combined gross domestic product of around \$12.5 trillion, surpassing the United States. It joins countries that were sworn enemies during the Cold War in a way that was unimaginable 20 years ago.

The date -- dubbed the "Day of Welcomes" -- is unquestionably historic, but perhaps not for the assumed reason, that Europe is taking another huge leap in an unprecedented march toward Continental unity. Instead, history might show that this date represents an apex for the European experiment, after which the Continent could never recreate with 25 members the level of unity and cooperation it reached with 15, much less push it forward.

Time will tell. Skeptics have prematurely reported the death of European unity for years, and the EU's proponents have consistently managed to prove them wrong.

Now the facts on the ground -- as well as the larger strategic picture -- do not bode particularly well for those who see Europe's largest expansion as a step toward even deeper and more meaningful integration. The challenges run the gamut from social to political to economic to security issues. These challenges will continue to create a range of pressure points that will make further [political integration](#) -- the EU's ultimate goal -- a fleeting dream.

As Stratfor argued in its 2004 Annual Forecast, expansion represents the [beginning of the end](#) for Europe's political integration. Meanwhile, if Europe fails to address fundamental, systemic weaknesses in its economy, the whole thing could blow apart in a storm of socio-economic nationalism that rejects the EU model as being in the fundamental best interests of its members.

Slouching Into Expansion

The European economy is mired in a period of economic underperformance that has pushed up unemployment levels across much of the Continent, with the largest eurozone economies -- Germany, France and Italy -- pushing double-digit unemployment rates. At the same time, rates of economic growth and productivity levels trail the United States and much of Asia.

Underlying Europe's persistent underperformance are structures inherited from the classic social welfare days: high pension and health costs, restrictions on firing, strong labor unions, legislated workweek restrictions. While these help protect labor and are widely popular, they restrict labor mobility and in general hamper attempts by European companies -- and countries -- to improve productivity and global competitiveness.

While Brussels for years has preached the need for deep [structural reforms](#), only the United Kingdom among Europe's big economies has been able to break significantly from its social welfare past. German, French and Italian reform efforts are largely [stalled](#), their political parties unable to muster support for major changes. It is no coincidence that British productivity and growth rates have outpaced its big Continental neighbors, as well as the eurozone average.

The formerly communist countries of Eastern Europe, on the other hand, have offered cheaper wage and

corporate tax rates -- as well as aggressive tax incentives -- that enable them to compete strongly for foreign direct investment from North America, Asia and parts of Western Europe, despite their shortcomings in infrastructure. Accession forced these countries to abandon their special tax incentive programs, forcing them instead to lower overall corporate tax rates. Of the incoming 10 countries, all but Malta have corporate tax rates below the median 33 percent rate of the EU-15, with figures such as 28 percent in the Czech Republic, 19 percent in Poland and 16 percent in Hungary.

The tax rate differential will put them into conflict with the EU-15, especially Germany and France, which will continue attempts to harmonize tax rate between old and new members.

Also, following expansion, companies in the accession countries will have to deal with more rigorous standards in everything from environmental rules to consumer and labor protection. While they certainly will benefit from improved access to EU markets and the general cachet that goes with being a full EU member, harmonization will be costly and will strip away many of the advantages from which accession countries currently benefit.

The promise -- for the accession countries' politicians and populations -- is that economic benefits will outweigh the costs. That is no longer as safe a bet as was once thought. Europe's inability to pull itself out of the economic doldrums is undermining confidence in the benefits of integration at a time when other issues are raising questions about the fairness and equity of membership.

One of the more sensitive and symbolic issues is [labor mobility](#) and general freedom of movement within the European Union. Restrictions on the ability of new members to move and work in the current EU-15-- or limiting their benefits in those countries if they do work there -- have engendered bad feelings in accession countries and prompted retaliatory restrictions in places such as Poland.

The EU has pulled a bait and switch on accession countries about issues such as voting rights within the European Union, [agricultural subsidies](#) and levels of [financial aid](#) to new members. The [unwillingness](#) of the EU's richest countries to make the sacrifices necessary to rein in the ballooning budget deficits -- with Brussels taking the council of European finance ministers to court over the issue -- could be interpreted by incoming states that have struggled to bring their budgets under control as a sign that sacrifice is a one-way street. This could make them less willing to compromise and less disciplined in their policies, especially under domestic political pressure.

As a whole, accession countries rank far below the EU-15 median per capita GDP of just more than \$28,000 -- outside Cyprus and Slovenia, the other eight accession countries have per capita GDPs of \$10,000 or less. Unemployment is a growing problem; Poland's unemployment rate tops 20 percent. The European Union risks losing cohesion early on if the accession countries do not see tangible benefits to membership that help to close that wealth gap.

Those economic issues play directly into the socio-political side of EU expansion. On both sides of the former border separating the EU-15 from the new EU-25, public support for accession was weak. The majority of people in some countries -- such as France -- actually opposed expansion. Outside of a small bump that might follow expansion day, that support is not likely to grow anytime soon.

On a practical level, getting things done will become substantially more difficult in a European Union that was unable to revise its policies and procedures even in advance of expansion. Brussels is pinning its hopes on resurgent negotiations for a [constitution](#). A deal could finally be in the offing, and Europe might be able to agree on a draft constitution by its June summit.

Actual approval could be elusive, however, requiring either parliamentary or popular approval in each of the 25 member states. With more and more countries contemplating public referendums -- including the United Kingdom, where the majority of the public in recent polls said they would vote against a constitution -- the process could take [years to finalize](#), and might never come to fruition. All the while, the EU will struggle to function within an institutional structure that it has clearly outgrown, making its bureaucracy even [slower and less responsive](#).

A Political Backlash?

[Economic concerns](#) and worries over everything from illegal immigration to rising crime have already been feeding a [nationalist revival](#) in much of the EU-15. Likewise, unfulfilled (or perhaps unrealistic) economic expectations will play into the hands of populist and quasi-nationalist political parties in the accession countries in a way that could generate a more organized resistance to further political integration among new members.

In Poland, by far the largest of the new members, the populist Andrzej Lepper has emerged as the country's most popular politician, putting forth a steady stream of EU-bashing and proposals -- such as the re-nationalization of some industries -- that would be anathema to Brussels. Lepper's anti-European Samoobrona Party is now the second-largest party in the country in terms of popular support, able to boast around 30 percent according to recent surveys.

Poland's ex-prime minister, Leszek Miller, has the burden of meeting EU accession targets to thank for his early exit from government, and his nominated replacement, Marek Belka, will face the political challenge of convincing the Polish public -- including the 40 percent who make up the low-income agricultural population -- to ignore Lepper's populist message.

The recent presidential election in Slovakia saw the two anti-EU candidates emerge for the runoff, with the pro-EU government candidate falling to a disappointing third. Popular skepticism about integration has been expressed by Czech President Vaclav Klaus, who one week before May 1 published a long editorial warning of the "loss of national sovereignty" that results from expansion.

Most of the accession countries are highly skeptical of a [Franco-German core](#) pushing the EU's political envelope into traditional areas of sovereignty, with foreign policy being the primary red line. Countries such as Poland, Hungary, the Czech Republic and the Baltics all are closer to the United States in terms of foreign policy; [fault lines exposed](#) in the lead-up to the Iraq war still exist.

In the days before May 1, Polish President Aleksander Kwasniewski said, "In foreign policy, our priority first and foremost will be taking care that the EU does not diminish the importance of the trans-Atlantic relationship." Like the United Kingdom, Poland and other new members will act as a counterweight to future attempts to forge a common foreign policy that diverges too far from Washington.

If the European economy falters too badly, or if pan-European politicians push too hard for new levels of integration at the political level, the [nationalist voices](#) in the eastern and western portions of the newly expanded EU will not hesitate to [raise a battle cry](#) and likely will find fertile ground for growth.

Recognizing this danger, integrationists might choose to continue, as Europe has for decades, with slow, incremental, bureaucratic gains. Europe's greatest strength -- in integrationist terms -- might actually be its ploddingly persistent bureaucracy. With expansion, the plodding will be even slower, however, and the great leaps that have occasionally pushed Europe forward will be even more difficult to come by.

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